2/19/81 B 4750-1 C

Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

Friday
(Noon)

Feb. 13, 1981

This was a dramatic week for financial markets, as participants focused on continuing indications of strength in the economy, together with the large financing needs of the Treasury. The pessimistic tone was sufficient to cause the markets to ignore indications that the Federal Reserve--contrary to most expectations--may have eased its policy stance somewhat at the FOMC meeting on February 3. Long-term bond rates rose rapidly to levels exceeding even the records set in early 1980.

The most important economic data released this week pointed to a surprising degree of strength in retail sales around year-end, together with a decline in business inventories in December. Thus despite historically high interest rates, the economy has recently continued robust--with the conspicuous exceptions of the credit-sensitive auto and housing industries. Such economic strength is almost universally expected to abate soon. Nevertheless, many market participants surely must be reflecting that the record of the past two or three quarters is a virtually universal underprediction of the degree of strength in the economy, with consequent misforecasting of interest rate trends. That attitude contributes to the mood of pessimism, especially in the intermediate- and long-term sectors of the market.

The other principal problem is the looming mass of prospective offerings. The corporate bond calendar is greatly swollen relative to levels in earlier years, and investors may confidently anticipate a surge of offerings, most likely during the first half of this year. But the issuer receiving most attention these days is the Treasury. Currently the Treasury's cash balance, at about $6 billion, is roughly half its year-ago level. That reflects in part the impact of the debt ceiling, which was only recently raised by Congress. Nevertheless, the fundamental fact is that the Treasury has a massive financing job to do in the months ahead. One could hardly imagine a less auspicious setting in which to pursue a discussion of whether tax cuts should precede, accompany, or follow budget cuts. If nothing else, the rapid rise of the rate on the Treasury's long bond to a record level suggests that investors are in no mood to experiment with Federal deficits near term, even if they share the long-run optimism of proponents of "supply-side" economics.

On Wednesday, the Fed allowed the Fed funds rate to sink precipitously without attempting to drain reserves. Funds averaged 14.33% that day, compared to 16.51% for the week as a whole. Though it is clearly too early to be certain, this action would appear to make sense only if the Fed's implied targets for discount window borrowing have been scaled down following the February 3 FOMC meeting. A likely rationale for such a change in the Fed's operating stance would be the very sluggish growth in M-1B, despite the infusions of NOW accounts into that aggregate. The Fed's inactivity today made the funds rate adjust downward, and further declines are possible. Sooner or later that will relieve some of the gloom in financial markets.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

Irving Trust

Market Yields

	2/13/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	19.50%	19.50%	15.25%
Effective since	2/3/81		
Discount Rate at Federal Reserve Bank	13.00	13.00	13.00
Federal Funds	16.50	17.00	14.75
Repurchase Agreements	16.00	16.65	12.50
U.S. Treasury Issues			
Bills			
3 months	16.35	15.75	13.63
6 months	16.22	15.33	14.15
1 year	15.12	14.50	13.82
Coupons			
2 years	14.53	13.78	13.10
4 years	14.08	13.33	12.25
7 years	13.64	13.10	12.20
10 years	13.58	13.02	12.15
Long Bond	13.19	12.66	12.10
Negotiable Certificates of Deposit-Secondary Market			
1 month	17.20	16.75	13.75
3 months	17.25	16.65	14.00
6 months	17.10	16.10	14.45
1 year	16.40	15.50	13.75
Banker's Acceptances			
1 month	16.85	16.50	13.60
3 months	16.60	16.40	14.00
6 months	15.90	16.10	14.50
Eurodollar Deposits			
1 month	17.88	17.44	14.75
2 months	18.06	17.44	14.88
3 months	18.13	17.44	15.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	16.00	15.50	12.75
1 month	16.25	16.00	13.00
3 months	15.50	15.50	12.25
Bank Holding Companies			
1 month	16.50	16.38	13.13
Dealer Placed:			
3 months	15.50	14.90	13.38
New AA Corporate Utility Bond	15.50	15.25	13.75
Tax Exempt			
6 month Project Notes	7.60	6.85	6.25
1 year AAA Bond	7.10	6.75	NA
5 year AAA Bond	7.75	7.40	NA
20 year AAA Bond	9.00	9.00	7.50

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

Cable Address:
"IrvingBank" Telex: I.T.T. 420268 • R.C.A. 232241
W.U.I. 62832 • French 82629